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WHAT SHALL WE DO WITH THE RAILROADS?

The general principles to be used in the solution of the railroad problem are simple, but attempts to apply them give rise to bewildering complexities. Our whole industrial organization is based on transportation. The threatened strike before the passing of the Adamson Law brought vividly to the attention of the public the extent to which we had become dependent upon railroad transportation. In so far as we are to depend on railroads for transportation, we wish to have adequate service, with rates as low as possible.

The historical development of railroads and regulation has helped to complicate the problem. The railroads in the United States have assisted in developing the country. They were frequently built ahead of the traffic. They were developed by private enterprise aided by government land grants or subsidies of money. The first effective regulation of railroads came in the seventies and was state regulation. Later, in 1887, Congress passed the Interstate Commerce Law, and federal regulation under the Interstate Commerce Commission began. For a long while this regulation was not effective, but Congress gave the Interstate Commerce Commission more and more power, until after 1910 they could control practically all features of the railroad business.

The regulation under the Interstate Commerce Commission has been successful in ending most personal and commodity discriminations. Place discriminations have been less generally remedied. Many place discriminations of old standing have not yet been corrected. Practically no progress has been made in the determination of what is a fair general level of rates. When the burden of proof was on the shippers they could not prove that the general level of rates was too high, and since the burden of proof has been shifted to the railroads they have been unable to prove that the general level of rates was too low. The difficulty has been in agreeing upon the amount upon which the railroads are entitled to earn a return. The Interstate Commerce Commission is now valuing the railroads. The law required them to compute the value on numerous different bases, such as original cost and cost of reproduction, new and with depreciation; but the law does not say which basis of valuation shall be used for rate-making.

For many years the roads have been attempting to increase rates to compensate for the increased cost of materials and the increased wages which in many cases were the result of semiofficial determination by arbitration boards; but the Interstate Commerce Commission refused to grant any substantial increase in rates. As a result railroad building almost ceased, and the amount of equipment was not kept up.

The European war brought increased traffic to the roads and greatly increased wages (some due to the Adamson Law and others to the competition with high wages in war industries) and high costs of material, especially steel and coal.

After the declaration of war by the United States the railroad presidents met in Washington and adopted a resolution agreeing to co-ordinate their operations and to subordinate everything to the task of getting the maximum of efficiency in transportation. They perfected an organization called the Railroads' War Board, which did much to promote the effective use of the railroads. The volume of traffic handled in 1917 was about the same as that handled by the Railroad Administration in 1918.

President Wilson took over the railroads on December 28, 1918, on the ground that the step was necessary for the public defense.

The proclamation said that the roads should get as compensation the average net operating income for the three-year period ending June 30, 1917.

The necessity for taking the roads over resulted partly from the limitations on co-operation on the part of the railroads, particularly the prohibition against pooling in the Interstate Commerce Law and the restriction against pooling and rate agreements by the Sherman Anti-Trust Law as interpreted by the courts, and partly from the conflicting use or rather abuse of priorities by the various government departments and war agencies.

Some of the necessity arose from difficulties inherent in the private ownership of the roads. Roads which with foresight had provided adequate terminals at great cost could not see why they should share them with roads which lacked either the foresight or the means to provide the terminals. The management as trustees for the stockholders were forced to promote the interest of their own roads.

In spite of the fact that the President's proclamation seemed to include all of the railroads of the United States, many of the so-called "short lines" were not taken over.

Mr. McAdoo, on being appointed Director General of Railroads, at once raised freight rates 25 per cent and raised passenger fares to 3 cents a mile and set aside state-made rates which conflicted. At first the operating staffs of the railroads were not changed; later, federal managers were appointed. Wage increases amounting to \$583,000,000 for 1918 were granted to employees, and the salaries of some of the higher officials were cut. Another saving consisted in abolishing the off-line offices and setting the traffic department at other tasks. It was thought that under unified control it would not be necessary to solicit traffic. A regional plan of operation was adopted. Starting with three regions, it has developed into nine regions and districts.

Congress finally passed the law setting the amount of compensation suggested in the President's proclamation. The contracts with the roads were to provide that the roads should be returned in substantially as good repair and as fully equipped as when taken over. The law said that federal control should continue for the

period of the war and might be extended for twenty-one months after the proclamation of peace.

A. H. Smith, director of the eastern region, has indicated some of the ways in which they increased the efficiency of operation:<sup>1</sup>

1. Unessential passenger trains were eliminated.
2. French, Russian, and western locomotives were given to eastern lines.
3. Transfer of power.
4. Use of less congested routes.
5. Company fuel and material were handled by direct routes.
6. Common use of terminals.
7. Interchange of labor to eliminate l.c.l. accumulations.
8. Restriction of equipment to certain classes of loading.
9. Freight trains run straight through to the West.
10. Co-ordination of harbor facilities.
11. Sailing days for l.c.l. freight.
12. Routing freight by the line reaching the pier from which it is to be shipped.
13. Using roads with the best grades.
14. Use of shops to repair locomotives of other roads.
15. Use of the same locomotive over several roads.
16. Sending freight through the Pennsylvania R.R. tubes.
17. Placing coal cars on team tracks in New York.
18. Sending bituminous coal direct to New York piers.

Much time was spent agreeing on the terms of a standard contract. By the end of the year comparatively few contracts had been signed.

Results of the year's operation compared with the previous year are given in the accompanying table.<sup>2</sup>

	1918	1917
Railway operating revenues.....	\$4,913,319,604	\$4,050,463,579
Railway operating expenses.....	\$4,006,894,762	\$2,858,212,210
Railway operating income (net revenue, less taxes, etc.).....	\$ 719,159,540	\$1,008,775,853
Ratio of operating expenses to operating revenues.....	81.55 per cent	70.57 per cent
Net ton miles of freight handled.....	434,997,928,000	427,341,924,000
Train miles.....	637,924,000	654,580,000
Freight car miles.....	22,056,329,000	22,532,507,000
Net ton miles per loaded car mile.....	29.1	27.0
Car miles per day.....	24.9	26.1
Net ton miles per car day.....	490.0	495.0

<sup>1</sup> Summarized from *Railway Age*, LXIV, 1466-68.

<sup>2</sup> *Ibid.*, LXVI, 407, 448-49.

The earnings indicate a deficit of about \$210,000,000 compared with the return guaranteed to the roads.

The armistice put an end to the war emergency. In his address to Congress, President Wilson said that the railroad problem gave him great concern and he turned to Congress for counsel, as he had no solution of his own. He declared that unless there was prospect of a legislative solution he would release the roads quickly. He stated as possible alternatives: to go back to the old conditions, to have complete government control, or to have private control with government regulation permitting unified operation, possibly with regional corporations combining the railroads in a definite area into a single system. He did not favor going back to the old conditions but did not pass judgment on the other plans.

The indecision of the President was not shared by many others. Of the many plans proposed, we shall consider in turn the ones suggested by the United States Railroad Administration, the Interstate Commerce Commission, the railroad executives, the railway supply men, railroad labor, the shippers, the state railroad commissions, and the security owners. We shall attempt to state briefly the proposals brought forward and then, without presuming to pass judgment on the plan as a whole, take up some of the novel points of the plan, often arguing that the changes proposed are undesirable. Finally we shall bring together the suggestions which seem to have merit.

#### THE UNITED STATES RAILROAD ADMINISTRATION

Mr. McAdoo, as his solution, proposed that federal control be continued until January 1, 1924. He gives as his reasons:

This extension would take the railroad question out of politics for a reasonable period. It would give composure to railroad officers and employees. It would admit of preparation and carrying out of a comprehensive program of the improvement of the railroads and their terminal facilities which would immensely increase the efficiency of the transportation machine. It would put back of the railroads the credit of the United States during the five-year period so that the financing of these improvements could be successfully carried out. It would offer the necessary opportunity under proper conditions to test the value of unified control, and the experience thus gained would of itself indicate the permanent solution of the railroad problem.

The American people have a right to this test. They should not be denied it. It is to their interest that it should be done. In my opinion, it is the only practicable and reasonable method of determining the right solution of this grave economic problem.<sup>1</sup>

Of course, this is a solution only in the sense of postponing action, and despite Mr. McAdoo's statement to the contrary would seem to imply a belief in the efficacy of government operation. Why could not an advocate of government ownership or any other plan say just as logically that the American people had a right to have his plan tried for five years? We grant that the period of the war was not a fair test of the efficiency of government operation, because all other things were subordinated to the main business of winning the war; but we do not see why the period of government operation should be extended, unless we are convinced that we wish to have permanent public control or government ownership.

There is no reason for thinking that Congress would give any more careful attention to the matter if it had five years for its consideration than if it has twenty-one months from the proclamation of peace. Again, if the roads are to be returned, and so far as the proclamation and the law are concerned we must assume that they are to be returned, it will be much simpler to make the adjustment for repairs and other items, and it will disrupt the organization less if the return is made at an early date.

Mr. Walker D. Hines, appointed Director General of Railroads after Mr. McAdoo's resignation, supported the proposal for a five-year period of control and made other suggestions as follows:

I believe there can be a form of radically reconstructed private ownership with such close government supervision, including government representation on the boards of directors, as will give the public and labor all the benefits of government ownership and at the same time will preserve the benefits of private and self-interested initiative and will avoid the political difficulties which perhaps are inseparable from government ownership. . . .<sup>2</sup>

In regrouping the railroads according to his proposed permanent regional organization under private management he would include one or two big systems as the backbone for each group. This grouping would have to be determined by some governmental tribunal, not by Congress, and in general he regarded it as unwise to divide big existing systems.<sup>3</sup>

<sup>1</sup> *Commercial and Financial Chronicle*, CVII, 2249.

<sup>2</sup> *Railway Age*, LXVI, 357.

<sup>3</sup> Cf. *Press Reports*, February 6, 1919.

For example, Mr. Hines suggested that one regional corporation be formed with the New York Central and New England systems and smaller lines naturally grouping with them, and another with the Pennsylvania and Baltimore and Ohio with smaller roads now physically associated with them. In this way, he said, six or more regional corporations would be created throughout the country with more uniform strength than a multitude of smaller companies with widely varying strength.<sup>1</sup>

This plan of regional companies made up of companies taken in their entirety is preferable to the ones which are purely geographical (as the one suggested by the President), and which would therefore involve dividing some of the present roads among several regions. Such a plan if carried out under private ownership would entail serious difficulties. Suppose that the Illinois Central had lines in three regions. The operating problem for through traffic would be complicated by the new scheme but would not be particularly serious. The great difficulty would be in the financial arrangements. How could the total valuation of the road be divided among the three regions? And would the three pieces be worth as much as the whole? What would the shareholders get in return for their stock? Would they get fractional shares in all the regional companies? Or would they be forced to take all the stock in one company? The difficulties with bonds would be still greater. Many bonds are secured by a lien on all the property of the road. If the road were divided among various regions the bonds would presumably be assumed by the regional companies, but by which company? Or in what proportion? Bonds with a lien on a specific part of the line divided between two regions would present a similar problem.

Combination is, in general, desirable and should be promoted, but the regional plan, whether geographical or otherwise, should not be made the excuse for a government guaranty of earnings. With a plan of regional companies formed by public authority, almost inevitably there would be pressure to have all the roads included, whether profitable or not, and to have the government guarantee a return on some valuation. The roads would probably be taken in on the basis of earnings, often gained from traffic diverted from other lines that could handle it more economically. This would

<sup>1</sup> *Ibid.*

cease if the roads were used only for economical traffic, and the roads would be a burden to the regional company.

#### THE INTERSTATE COMMERCE COMMISSION

The Interstate Commerce Commission, in its annual report for 1918, refused to recommend concrete plans for the solution of the railroad problems and contented itself with pointing out certain desirable ends and certain legislation needed if the various alternatives were adopted. Later, before the Senate Committee on Interstate Commerce, Commissioner Clark testified:

Considering and weighing as best we can all of the arguments for and against the different plans, we are led to the conviction that with the adoption of appropriate provisions and safeguards for regulation under private ownership it would not be wise or best at the present time to assume government ownership or operation of the railways of the country.<sup>1</sup>

He also made certain suggestions for legislation:

1. Revision of limitations upon united or co-operative activity among common carriers by rail and by water. . . . The regulating tribunal should have authority to prescribe not only the maximum which the carriers may charge, but also the minimum. . . .
2. Emancipation of railway operations from financial dictation. . . .
3. Regulation of issues of securities. . . .
4. Establishment of a relationship between federal and state authority which will eliminate the twilight zone of jurisdiction and under which a harmonious rate structure and adequate service can be secured state and interstate. . . . The conflict of jurisdiction as between the federal government and the state could probably be resolved through harmonious co-operation if the federal tribunal could be authorized to co-operate with state authorities by utilizing their services in appropriate instances and to an appropriate extent.
5. Restrictions governing the treatment of competitive as compared with non-competitive traffic. . . .
6. The most efficient utilization of equipment and provision for distributing the burden of furnishing equipment on an equitable basis among the respective carriers. . . .
7. A more liberal use of terminal facilities in the interest of proper movement of commerce . . . the regulating body . . . require the enlargement of terminals. . . .
8. Limitation within which common-carrier facilities and services may be furnished by shippers or receivers of freight.<sup>2</sup>

<sup>1</sup> *Railway Age*, LXVI, 134.

<sup>2</sup> *Ibid.*, LXVI, 135.

Thus the policy proposed is private operation with further development of governmental regulation. Without agreeing with all of the changes proposed, this on the whole appears to be the wisest course.

There is grave question whether harmonious action with the state railroad commissions could be obtained by utilizing their services in local cases. The law might eliminate the twilight zone of jurisdiction over rates, but this alone would not make the state commissions innocuous. They would still be able to interfere with classifications, size of cars, lengths of trains, demurrage, and other practices. The fundamental defect of forty-eight states attempting to regulate a national matter would still exist, with all of its possibility of complexity and confusion; and no change would be made in the spirit of the shippers who demand that they be favored at the expense of shippers from other states.

The proposal to regulate the issuing of securities and to require the enlargement of terminals is rather a sharp break with our past practice. Many of the states have regulated the issuing of securities for a considerable time. The results have not been startlingly good nor startlingly bad. With federal incorporation, it would go without question that if regulation were desired it should be federal. Also it is clear that exclusive federal regulation would be preferable to the conflicting regulation of the states. But with most of the railroads incorporated under state laws and subject to state regulation of the issuing of securities, the addition of federal regulation might merely complicate the financial matters without bringing any improvement.

The terminal problem has two serious aspects, the question of joint use of terminals and the question of adequacy. Undoubtedly some roads have been selfish in their policy of not allowing others to use their terminals. It would help to have a public authority which had the power to require joint use and to set the rental in case the parties could not agree. The roads are accustomed to say that if they are given a chance to earn a good return on their property they can handle the question of adequacy. The thorny problem in connection with requiring the enlargement of terminals is how they are to be paid for. Obviously the money must come from

the users of the railroad, but should it be in the form of a general rate increase, or an increase in rates directly affected by the terminal? If the regulating body has power to require extensions there might be pressure to have the government guarantee a return on the investment. Aside from the difficulty of deciding whether the terminal had been profitable or not, it might lead to a demand for a guaranty of a return on the whole railroad property, a policy which we should not adopt.

#### THE PLAN OF THE RAILROAD EXECUTIVES

The intimate knowledge of the problem possessed by this group is conceded, and the results of their combined deliberations should have value. They propose:

1. The creation of a Department of Transportation, headed by a secretary, who would sit at the President's council table, who would relieve the Interstate Commerce Commission of its executive duties; and in whose jurisdiction would be centered rate regulation subject to revision by the Interstate Commerce Commission, and the fixing of wages, and who would use the power of the administration to maintain proper service, to create the necessary credit for the carriers, and to maintain harmonious relations between employers and employees.

2. The adoption of a fixed policy as to the revenues of the carriers by requiring that the influence of the President, through his secretary of transportation, shall be put behind movements for increased rates which he finds proper, and the establishment of a statutory rule for rate-making, which shall require that rates be not only reasonable but adequate and sufficient to protect existing investment and to attract capital necessary to maintain existing properties up to the standard of the public need, and for the construction of extensions and branches.

3. To provide for compulsory federal incorporation and for the elimination of the conflict of regulating power between the states and the federal government as to all essential matters, including rates, state and interstate, with as little interference as possible with the state commissions in carrying out the intended purposes.<sup>1</sup>

Many of their suggestions are admirable. The most striking proposal is that we should have a Department of Transportation headed by a cabinet officer. Presumably the railroads hope by this method to get more speedy and sympathetic action in the

<sup>1</sup> *Commercial and Financial Chronicle*, CVIII, 733.

matter of rate changes. The Secretary of Transportation would be appointed for political reasons and would change at least as often as administrations changed. The lack of continuity and the necessary political bias are against the idea of control by a cabinet officer. The appointment being made for political reasons, there is a chance that an incompetent man would be appointed. Perhaps there would grow up efficient, permanent, undersecretaries; but in that case the flexibility and quickness of action would be lost.

The requirement that rates should be high enough to attract the necessary capital to keep up the roads at first thought appears fair enough and is safeguarded by giving the Secretary of Transportation control of investment of capital by roads in branches and terminals. However, the procedure to be used is not clear. Suppose the Secretary of Transportation decided that new terminals were needed at certain places, and the conditions in the money market were such that capital could be obtained on a 7 per cent basis, as compared with a previous rate of 6 per cent. Now would the railroad rates be adjusted so that the roads could earn 7 per cent on their entire capital, both old and new, or would they be allowed to earn 7 per cent merely on that part of their capital which represented new investment? If they are permitted to earn the higher rate of return on their whole property, then the public should be assured that in case the interest rate falls the railroad would be allowed a rate level no higher than necessary to earn the lower rate of return on the whole property.

#### RAILWAY SUPPLY MEN

The Railway Business Association, representing various supply houses, filed a statement with the Senate Committee on Interstate Commerce. They argue for the retention of competition in purchasing supplies in order that inventors may have a chance to develop improvements.

While permitted to co-operate with one another so as to eliminate duplication of facilities and to secure the most efficient and economical use of routes, terminals, and vehicles, and permitted under federal sanction to effect consolidations if essential, railway properties should be operated by independent federal corporations as numerous as may be consistent with their financial strength and stability. . . . .

One of the conditions under which manufacturers of equipment can best perform the service which the public rightfully expects from us is that in whatever adjustment Congress adopts the individual railroad shall remain clothed with full discretion as to design, specification, and purchase, and that there shall be as little consolidation of lines as may be consistent with the financial strength and stability of the several roads. . . . .

As furnishers of railway necessities, we assure you of our conviction that dealing with a railroad owned by the government would be dealing with the government, even though the government were to go through the form of delegating operation to a company nominally private. We would expect production of equipment to be centralized in due course. We would look upon such an arrangement as the beginning of the end of mechanical progress, and as the signal that inventors and developers of invention had better seek other occupations. . . . .

From the foregoing it follows that the provision of transportation facilities could be carried on more advantageously to all concerned if the railway companies were placed in a position such that when traffic is large they may accumulate a surplus and in time of light traffic employ such surplus in confidence that the rate and revenue policy of the government will be adequate, stable, and permanent. . . . .

We favor the adoption by Congress of a policy under which regulation of maximum and minimum rates of carriers engaged in interstate commerce would be federal only.<sup>1</sup>

The activities of the Railroad Administration in attempting to standardize locomotives and cars roused the equipment men. The argument for standardization was that the equipment could be produced more rapidly and could be repaired easily at any place. As it worked out, there was great delay in developing the designs, and little of the standardized equipment was produced before the armistice was signed. They might have ordered locomotives and cars from the old designs while they were developing the new. Locomotives are used under such diverse conditions of grade, curvature, clearance, and strength of bridges that it is doubtful whether standardization can be obtained without sacrificing efficiency. Roads had developed the idea of standardizing as many of the parts as possible on the various classes of locomotives. The building of cars affords rather more chance for standardization, though clearances, character of load, and weight of bridges

<sup>1</sup> Railway Business Association, statement filed with the Committee on Interstate Commerce of the United States Senate by W. W. Salmon, pp. 2, 4, 5, 10.

on different roads call for different types of cars. Industrial combinations often claim that they can afford to experiment and develop new processes better than the smaller concerns. Evidently the supply men wish to continue as independent businesses instead of having their inventors on the staffs of the railroads.

#### RAILROAD LABOR

It is rather significant that none of the other parties interested recommends government ownership. It remained for the employees to do that. It is not impugning their sincerity to believe that part of their reason for favoring it arises from the fact that they have obtained much more than they ever hoped to in the way of wage increases. Mr. Glenn E. Plumb, as the spokesman for organized railroad labor, proposed before the Senate Interstate Commerce Committee:

Government ownership of all railway properties; operation by a single corporation, dividing profits equally between the employees and the government, and directed jointly by representatives of the employees, operating officers, and the public; automatic reductions of rates when profits exceed a certain amount, and retention of the Interstate Commerce Commission of the present power to regulate rates.<sup>x</sup>

The chief error is the assumption that by the new arrangement we could obtain all the advantages of private operation plus certain advantages of unified operation. These advantages are to show themselves in lower rates and profits to be divided between the government and labor. Most people frankly doubt whether government ownership and operation would be efficient.

The financial burden involved in taking the roads over at this time would be very great. The plan includes all the railroads and would mean the purchasing of a large number of short lines which are not profitable. The argument frequently advanced by advocates of government ownership about the saving of interest due to replacing railroad bonds with government bonds bearing 2 per cent to 3 per cent has been effectively answered by the necessity of raising the rates on the Liberty Loans, even though patriotism and social pressure removed the transaction from the strictly

<sup>x</sup> *Commercial and Financial Chronicle*, CVIII, 644.

economic appeal. Of course, some saving in interest would be made, but it would be slight.

The hope that profit sharing would induce efficiency on the part of the workers overlooks the fact that the volume of traffic is the prime cause of variations in the net earnings of the railroads, and that the employees would have no control over the volume of traffic.

#### THE SHIPPERS

Mr. Clifford Thorne, representing the American Petroleum League, the National Live Stock Shippers' League, the National Council of Farmers' Elevator Associations, and the Western Refiners' Association testified before the Senate Committee on Interstate Commerce in part as follows:

Government operation is so distasteful among the shippers of the United States, that, were a popular vote taken today, it would be defeated overwhelmingly. . . .

It is of paramount importance to the stability and progress of American industry that you shall immediately restore the full powers of our courts and commissions over the railroads of the United States. . . .

We most earnestly petition the present Congress to amend section 10 of the railroad control law as follows: first, restore the suspension powers of the Interstate Commerce Commission, which will assure us a decision by a disinterested tribunal before any more sweeping revisions shall become effective; second, strike out the clause which attempts to make the orders of the President superior to state and federal law and the common law; and, third, insert a clause requiring the director general to pay final judgments against common carriers under his control, and charge the same to operating expenses, where so chargeable prior to government operation. . . .

Turning to the question of revision of rates, Mr. Thorne said that the so-called 25 per cent increase resulted in increases of from 100 to 275 per cent in some instances and practically effected an increase of several hundred per cent in some cases where state classification was superseded by the interstate classification with a higher minimum weight. . . .<sup>1</sup>

The shippers who are the most vocal evidently think that the Interstate Commerce Commission and the state commissions have looked out for their interests. They have nothing constructive to offer and merely wish to return to the former conditions. Certainly they are justified in insisting that no arbitrary action be taken about rates. In some cases their objection arises because

<sup>1</sup> *Railway Age*, LXVI, 307-8.

by superseding the state commissions, discriminations have been removed which were the results of the efforts of the state commissions to further the interests of their own shippers. In such cases they deserve no sympathy; but many of their complaints against the Railroad Administration are justified.

#### THE STATE RAILROAD COMMISSIONERS

As typical of the opinions of this group we may take the testimony of Mr. Charles E. Elmquist, president of the National Association of Railway and Utilities Commissioners, before the Senate Committee on Interstate Commerce.

He said that centralization of all power over the railroads in the hands of one individual during actual warfare is dangerous, but in times of peace it becomes a positive menace which should be removed at once, and he therefore recommended the repeal of Section 10 of the Control Law to take from the President "the alleged right" to set aside state or federal laws or orders of the commissions applicable to common carriers and to restore the suspension powers of the Interstate Commerce Commission. While the state commissions are of the opinion that the federal control act did not deprive them of jurisdiction over state rates, he said that not one of them made any attempt to exercise their authority during the war, but for the purpose of avoiding litigation now they want the law made specific.

Mr. Elmquist argued at length as to why the states should continue to regulate local rates and service and opposed the establishment of a central bureau at Washington to handle such matters, but he thought that a satisfactory plan of co-operation could be worked out between the state commissions and the Interstate Commission. He also declared that the railroads need not fear that the commissions will fail to recognize the changes in conditions which have required higher rates in case they are again brought under the jurisdiction of state regulation.

As to various plans for changes in regulating methods for the future, Mr. Elmquist favored the prompt merger of the railroads into a unified system, in times of stress or emergency under provisions to be established by Congress, and the merger within proper

limits of carriers' lines and facilities to such an extent as may be necessary in the public interest to meet the reasonable demands of commerce with the approval of the Interstate Commission. He also favored the consolidation of terminal facilities whenever public interest will be favored thereby, but believed that this question could be very properly passed upon by state authorities. He favored the limitation of railroad construction to the necessities and convenience of the public under regulation of the federal authorities in addition to that of local authorities. He favored the control of securities by the federal government, but under a plan which would require copies of applications to be filed with state authorities, thus enabling them to submit evidence and recommendations. The state commissions also, he said, would favor any proper plan which may be devised for bringing the relation of interstate carriers closer to the people. If Congress considers it desirable to do so, they then believe that it could best be done by increasing the membership of the Interstate Commerce Commission and by requiring one or more members of that body to hear and try all cases in the affected localities. In the absence of such a plan it might be advisable to make each state commission a regional commission to act for the federal commission in all proper matters.<sup>1</sup>

It is clear that the state commissions are restive under the restrictions on their activities by the United States Railroad Administration. Probably they are justified as far as the constitution and the law are concerned. However, it would be desirable to limit the rate-making powers of the state commissions and their control over rules and classifications. The problem of rates is a national one, and selfish state interests should not be allowed to interfere with its solution on national lines. Local rates have been used to discriminate against shippers in other states and so must be controlled by federal authorities.

Consolidation of terminals as to location would seem to be a proper subject for municipal rather than state control. In its relation to transportation it clearly involves more than local areas. Terminals in New York City affect transportation over a large part of the United States.

<sup>1</sup> *Railway Age*, LXVI, 360.

Federal regulation of securities would be preferable to state regulation. Cases have arisen where it was necessary to get the consent of a number of state commissions before a reorganization plan could become effective, and they often have taken a narrow and selfish view of the matter. If the states are willing to give up their regulation there would be no objection to assuring them that proposals affecting their states should be submitted to them, and that they should be given a chance to produce any evidence they desired.

The proposal to treat the state commissions as regional commissions presents difficulties. They might be consulted, but as long as the federal government has no control over their appointment they could hardly be allowed to make decisions. Some of the states have able commissioners, but in others the men are given the place as a reward for political effort, and no regard is paid to competence.

#### SECURITY OWNERS

No one will question the vital interest of the holders of railroad securities in the outcome of the present discussion.

The plan submitted by Mr. S. Davies Warfield, president of the National Association of Owners of Railroad Securities, may be taken as representing their point of view. He proposed:

1. A minimum rate of return on the property investment in the railroads, *fixed* by act of Congress, through rates adjusted as occasion may demand, in order that the securities of the railroads may be stabilized and their credit established on a basis necessary to secure the money to provide to the shippers and traveling public adequate facilities and service.

2. Recognition that a fixed return through rates that will enable the average railroad to receive an adequate return on its invested capital is not possible without giving to the more favorably situated railroads more revenue than the public will sanction, or more than would represent a fair return on its property. The earnings of railroads in excess of a fixed reasonable rate of return to be applied as provided in the following section.

3. A distribution, under the control and jurisdiction of the Interstate Commerce Commission, of a percentage of the fund above provided, that railroad employees shall receive the benefit of profit sharing, by insurance, or by such other legal methods as may be determined upon; likewise a distribution of a percentage thereof among the railroads earning it, and under the plan, and in furtherance of incentive and initiative by establishing operating efficiency

standards; for certain improvements to railroad property, under restrictions, not to be capitalized in rate-making; and for other purposes defined in the plan.

4. A corporation, created by act of Congress, operated without profit to the railroads, and under federal control, directed by trustees composed of the nine Interstate Commerce Commissioners and eight railroad men, to finance in the present emergency, such equipment as may be purchased by it from the Railroad Administration and allocated to the railroads, and to furnish an immediate means for assisting in financing the return of the roads; continued as a permanent means for mobilizing and purchasing equipment to be leased to the railroads; to provide a management or agency to continue or put into effect the joint use of terminals, unification of facilities, re-routing of freight by pooling or otherwise, and to continue or adopt such methods of operation as may have been found to be successful and expedient during federal control; to furnish a standing, trained and efficient means for immediate mobilization of the railroads for war purposes without additional legislation.

5. Federal regulation extended through the Interstate Commerce Commission as at present established, co-ordinating therewith subsidiary commissions as regional commissions, the members thereof selected equally from the two leading political parties appointed from and sitting in the six traffic territories as at present defined, giving to such bodies the determination of rates and regulations. The right of appeal is given to the Interstate Commerce Commission, which may be designated Commission of Appeal.

6. Continuation of rate committees composed of representatives of both railroads and shippers in defined territories, to primarily consider and pass upon all changes in rates requested by either railroads or shippers and before being filed with the regional commissions or Interstate Commerce Commission.

7. Co-ordination, by the Interstate Commerce Commission, of the work of the state commissions, as far as the limitations of law and the legislation provided under the plan will permit, with that of the regional commissions. The adjustment of intrastate rates to the requirements of the interstate commerce as prescribed through interstate rates is vested in the federal commissions.

8. Regional commissions act as boards of conciliation for the settlement of wage differences between the railroads and their employees. In default of settlement such commissions shall appoint two arbitrators, the employees naming two, the four so selected naming the fifth if required. Appeal may be taken to the Interstate Commerce Commission; the findings not to be compulsory unless mutually agreed beforehand. A fixed return being provided under the plan, expenditures for wages or other elements entering into expenditures are supervised by the commissions.

9. Future issues of railroad securities supervised by the regional commissions and the Interstate Commerce Commissions.<sup>1</sup>

<sup>1</sup>*Railway Age*, LXVI, 351.

The plan has the merit of recognizing the need for adequate rates to make efficient service possible. There are many points not made clear. "Property investment," "invested capital," and "property" are all used as being the amount on which earnings are to be allowed, but they are not adequately defined. If the entries on the present balance sheets of the railroads are to be taken as indicating property investment there will be cases of both over-and under-capitalization on any basis of capitalization other than par value of securities. Perhaps the idea is that taking all the roads the cases of under- and over-capitalization would offset each other.

If a new road were built in a region not needing it, and if it caused no increase in traffic, rates would be raised to yield the minimum return on the property investment—a strange result for an increase in facilities. Railroad earnings fluctuate greatly with variations in prosperity of general business. Unless this minimum return is to be taken as a long-time average, we would have rates raised in time of depression to compensate for the falling off of traffic.

If the present book value of the railroads is taken as the property investment we have the essentially immoral result of rewarding reckless and penalizing conservative capitalization. Take two granger roads with about the same plant and business, one heavily and the other modestly capitalized. Suppose their earnings are the same and just sufficient to pay 6 per cent on the property of the heavily capitalized road. It keeps all of its earnings, while the modestly capitalized road must share its earnings with its employees and the public.

The suggestion that shippers help make rates implies rather more organization on the part of shippers than exists. It is doubtful whether it would be better than the present method of allowing shippers to present their case at rate hearings when the particular rates which affect them are under consideration.

It would hardly be feasible to leave to Congress the setting of the rate of return. The rate of return would need to vary with changes in investment conditions, and Congress would have neither the inclination nor the expert knowledge needed to make quick

and accurate readjustments. Perhaps the security holders hope for a rate set high enough to be adequate for a long time.

While doubtless there are many minor cases which a regional commission could handle, most of the serious problems are inter-regional, such as transcontinental rates and the relation of rates to the Atlantic and Gulf ports. The attempt to meet the problem of conflicting state and federal regulation by suggesting co-operation is rather futile. Some legal basis is necessary. Wage determination and rate determination undoubtedly should be more closely connected.

#### CONCLUSION

Thus we have proposed, by the United States Railroad Administration, a five-year period of federal control and the development of regional companies; by the Interstate Commerce Commission, closer financial control, the permitting of united action, and more regulation of service and equipment; by the railroad executives, federal incorporation and a Secretary of Transportation who would see that the railroads got adequate rates; by the railway supply men, co-operation in the use but competition in the procuring of equipment; by railroad labor, government ownership with the profits shared between the employees and the government; by the shippers, a quick return to conditions existing before the roads were taken over by the government; by the state railroad commissions, giving them their former power and development of new functions in connection with the Interstate Commerce Commission; and by the security owners, legislation to assure a return to the railroads, and regional commissions in addition to the present Interstate Commerce Commission.

While the foregoing proposals have many strong points, there are also features open to objection, some of which have been pointed out. What follows will be an attempt to bring together suggestions for our future railroad policy, summarizing, without repeating the arguments, the points we have considered previously. The railroads should be returned to their owners as soon as the needed changes have been made in the methods of regulation. The aim of the changes should be to permit more unified action on

the part of the railroads; to set a definite basis for rates; to provide a method for settling wage disputes; and to provide adequate facilities both in the way of extensions and new terminals and with respect to service.

The federal government should be the regulating body. The state commissions should be deprived of all control over rates, classifications, and rules. These are national problems and should be solved on that basis. We admit the early usefulness of the state commissions and can see a place for them in the control of local utilities; the valuation of railroad property for purposes of state taxation; and perhaps an irreducible minimum of regulation under the state police power in the interest of health and safety. Some of the state commissions have assumed that their function was to get as many advantages as possible for the shippers of their own states, even though the advantages caused discriminations against the shippers of other states. A logical following out of the Shreveport case would seem to make it possible for Congress to declare that no state rate should vary from the standard set for interstate rates, in order that there might be no discrimination between places.

The old policy of attempting to check combination should give place to the policy of fostering combination. Probably the best method of procedure would be federal incorporation. The anti-trust laws might be amended by exempting from their provisions railroads with federal charters granted after a certain date. The federal charters could contain provisions for any desired regulation of capitalization, rates, accounts, service, and the terms on which mergers might be made. In making the combination perhaps it would be necessary to permit the federal corporation to be a holding company; but as soon as possible the corporate structure should be simplified. The minority stockholders should be protected against any attempt to acquire their property at an undervaluation, and the company should be protected against any attempt of the minority to hold up the merger unless their holdings were taken at an overvaluation.

The probable result of such permission to combine would be the formation of a relatively small number of large, strong companies,

but many of the short and unprofitable lines would be left outside. Many of these roads are not economically justified. Mr. McAdoo did not care to be burdened with them. They perform, of course, a transportation service of value to the points along their lines which have no other railroad connection; but they could not exist with merely the business of such points. Their search for profit has led them to develop roundabout hauls. Any regional plan or government ownership or guaranty would probably involve the purchase of the roads on the basis of cost or a valuation obtained by capitalizing the returns from this wasteful or roundabout transportation, and the public would ultimately stand the cost. If, however, the short line is one which promises to develop valuable traffic it would be taken over by the bigger road. The big, strong roads could (assuming that provision has been made for adequate rates) finance necessary terminal developments and extensions. This policy seems preferable to one which involves public ordering of new facilities or public veto of new projects.

In this country we have never had any control over railroad building in the sense of preventing roads from being built. In the early days, when special charters were necessary, the public was interested in promoting the building of roads, and in later days under general incorporation laws there has been practically no restraint on the building of roads. This policy must come to an end if we adopt the program of public or private monopoly, or of a government guaranty; for we could not permit private individuals to encroach on the monopoly, and it would be ruinous to ask the government to stand ready to guarantee a return on any road that anyone might care to build.

One form of co-operation from which much may be expected is pooling. All the gains which the Railroad Administration has made by eliminating competitive traffic can be obtained by allowing the roads to pool their traffic. It is presumed that the pooling contract will be based on freight or passenger rates which have been sanctioned by public authorities, and that the terms of the agreement have been approved by the regulating body, which would have the power to cancel the agreement should it appear for any reason not to promote the public welfare. If the shipper is to con-

tinue to have the power to select the route, the pool would need to be a money pool. The railroads allege that great savings can be made if, as is the case under the present governmental control, they can send the freight by the line which is least congested or which reaches nearest the point of delivery, thus eliminating lighterage or car ferry or other terminal service. The railroads sometimes allege that the shipper desires the control of routing of freight to use as a club to get preferential treatment of some sort. The shipper insists that he knows better than the railroads the most convenient point of delivery, and that he has the right to pick the road which gives him the best service. Perhaps we might permit the shipper to choose the route in ordinary times and reintroduce, in times of congestion, the permit system and loss of right to designate the route.

The problem of the general rate level is very complex. The railroad has a relatively large fixed investment, which makes its net earnings fluctuate greatly, as the result of moderate changes in the amount of business. The volume of traffic varies greatly from year to year, though the general trend in the United States has been upward. Obviously a rate system, to be fair, must be based on an average of a number of years. The large amount of fixed capital also brings difficulties in connection with the variety of services performed by the railroads. The general expenses are apportioned to the various classes of traffic and to the traffic from the various localities in accordance with the principle of charging what the traffic will bear. There come to be adjustments between different places or different commodities expressed as differentials. The differential may be a fixed sum or a certain percentage above or below the other rate. Any change, such as the 5 per cent increase allowed by the Interstate Commerce Commission, or the 25 per cent increase initiated by Mr. McAdoo, is bound to upset many of these long-established differentials. The railroad thus differs from a public utility furnishing but one or a few products, where rates may be changed easily up or down if the earnings are too small or too large.

The chief need in relation to adequacy of rates is a definition by Congress of the amount upon which a road is to be allowed a fair

return, and which road's valuation is to be taken in case more than one road exists in the territory under discussion. In trunk-line territory, for example, a given rate level might give the Pennsylvania more than adequate earnings and the Baltimore and Ohio less than adequate earnings. There is no way to escape the fact that a given set of rates will permit different roads to earn varying returns. Perhaps we should be forced to fall back on Marshall's idea of a representative firm, in this case a railroad, one fairly well located and equipped and run with fair ability, and provide rates which would enable it to earn a fair return. The present valuation being carried on by the Interstate Commerce Commission does not set a definite value for rate-making. Congress should decide which one of the many values found is to be the basis, and then the Interstate Commerce Commission should prescribe the accounting methods necessary to keep it up to date. While the advocates of the various methods of valuation would not agree that all were equally good, most of them would admit that an authoritative determination of a definite basis for valuation for rate-making is needed.

The wages question involves finding methods to prevent the tie-up of the railroads in case of disagreement, and insuring that increases or decreases in wages shall, if other items of expense do not compensate, cause readjustments in rates. Compulsory arbitration might help in the solution of the first problem; but we must remember that in a democratic country there is no effective way to enforce a decision adverse to the employees. If the law based rates on costs, then wages would necessarily be considered by the Interstate Commerce Commission in the adjustment of rates. In some way the Interstate Commerce Commission should have some responsibility in the determination of wages to prevent the situation which has happened frequently, when it refused to grant increases in rates after arbitration boards had given increases in wages to the men.

To improve service we need adequate rates to make possible the provision of terminals, trackage, and equipment, and the development of standards of service; and finally the Interstate Commerce Commission should be given power to enforce the stand-

ards of service. This is a new field. We have developed machinery to prevent discrimination in the distribution of coal cars but have no definition of adequate supply, and no way to force the roads to furnish such a supply. "Sailing day" plans for l.c.l. freight save train mileage, but it is doubtful whether they would be considered as offering adequate service. But we have no definition as to what constitutes adequate service for the various kinds of traffic. The need for such a definition is obvious.

The conclusion is that we should return to the private operation of railroads, giving them a chance to act unitedly under the direction of the Interstate Commerce Commission, unhampered by state regulation. Wage and rate control should be in the same hands. We wish to get as far as possible the advantages of private initiative along with any savings resulting from united action supervised by public authorities. We should avoid any government guaranty or any saddling upon the public of unprofitable roads.

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